kotak® Institutional Equities

INDIA DAILY

July 19, 2007

EQUITY MARKETS

	Change, %			
India	**18-Jul**	**1-day**	**1-mo**	**3-mo**
Sensex	15,301	0.1	7.0	12.3
Nifty	4,500	0.1	6.8	12.6
Global/Regional indices				
Dow Jones	13,918	(0.4)	2.1	8.7
Nasdaq Composite	2,699	(0.5)	2.8	7.7
FTSE	6,567	(1.4)	(1.3)	2.0
Nikkie	18,065	0.3	(0.5)	4.0
Hang Seng	22,842	(0.9)	5.8	12.5
KOSPI	1,934	0.2	7.0	27.8

Value traded - India

	Moving avg, Rs bn			
	18-Jul		**1-mo**	**3-mo**
Cash (NSE+BSE)	168.0		161.4	146.2
Derivatives (NSE)	450.5		307.9	279.5
Deri. open interest	864.7		699.8	566.4

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Change in recommendations

Aditya Birla Nuvo: Too fast, too furious; reduce to In-Line

Updates

Insurance: Bajaj Allianz NBAP margin likely higher than our estimate, increasing SOTP estimate

Forex/money market

	Change, basis points			
	18-Jul	**1-day**	**1-mo**	**3-mo**
Rs/US$	40.3	-	(40)	(175)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	7.8	(7)	(35)	(27)

Net investment (US$mn)

	17-Jul		MTD	CYTD
FIIs	232		1,759	8,315
MFs	(26)		112	(259)

Top movers -3mo basis

	Change, %			
Best performers	**18-Jul**	**1-day**	**1-mo**	**3-mo**
RELIANCE CAPITAL	1,171	(0.6)	8.7	66.4
BALAJI TELEFILMS L	255	(2.5)	9.4	57.6
STATE BANK OF IND	1,575	(0.3)	14.8	49.5
GUJARAT NARMAD	135	(1.7)	27.5	44.5
ACC LIMITED	1,133	2.0	34.3	43.8
Worst performers				
POLARIS SOFTWARI	140	(6.0)	(10.5)	(27.9)
RAYMOND LIMITED	297	(1.0)	(7.2)	(17.8)
SUN PHARMACEUTI	997	(0.5)	(4.6)	(14.0)
WIPRO LTD	504	(0.2)	(3.2)	(12.9)
CIPLA LTD	206	(0.0)	(0.6)	(12.0)

News Roundup

Corporate

- In keeping with its growing appetite for overseas acquisitions, the Tata group is evaluating a bid to buy luxury British car brands Jaguar and Land Rover from the struggling US car maker Ford.(BS)
- Hindalco Industries today announced an agreement with Canada-based Alcan to acquire its participating interest in the Utkal Alumina project in Orissa. According to an official release issued by Hindalco, the transaction is likely to be closed in the next 30 days. The conclusion of the transaction will mark the complete exit of Alcan from the Utkal project. (BS)
- Bharti Airtel has awarded Ericsson an estimated $2 billion contract including expansion of its GSM/EDGE network and providing capacity management. Under the two-year supply and services contract, Ericsson will design, plan, deploy, optimise and manage Bharti's GSM network across 15 circles in India as well as its pan-India pre-paid (IN) platform across 23 circles. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

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Utilities

RLEN.BO, Rs689	
Rating	OP
Sector coverage view	Attractive
Target Price (Rs)	780
52W High -Low (Rs)	724 - 407
Market Cap (Rs bn)	156.8

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	57.1	62.2	67.0
Net Profit (Rs bn)	7.5	6.1	6.2
EPS (Rs)	34.8	26.7	27.3
EPS gth	*(4.0)*	*(23.4)*	*2.2*
P/E (x)	19.8	25.8	25.3
EV/EBITDA (x)	23.7	27.8	26.6
Div yield (%)	0.5	1.0	1.0

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	34.4	-	-
FIIs	22.6	0.4	0.0
MFs	6.6	0.8	0.4
UTI	-	-	(0.4)
LIC	13.9	1.4	1.0

Reliance Energy: 1QFY08: Operating performance on track, one-offs hit operating profits

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- **Operating performance on track.**
- **Higher revenues from EPC business to continue as order book swells.**
- **SOTP based target price of Rs780/share.**
- **Equity investments could provide upside.**

Reliance Energy (REL) reported revenue growth of 40% (we estimated 19.9%) and EBITDA decline of 71.8% (we estimated increase of 37%). While the revenues growth in EPC was in line with estimates, higher cost of electricity purchases propped up the topline. We estimate electricity sales in Mumbai distribution circle to have increased by 12% yoy resulting in 16% increase in electricity purchases. Change in accounting policy (with effect from April 1, 2007) to reflect the fair value of foreign exchange derivative instruments resulted in a charge of Rs826.7 mn, resulting in a decline in reported EBITDA. Realization of higher retail tariffs from April 24, while higher bulk tariffs became applicable from April1, resulted in loss of revenues for REL in Mumbai. REL has appealed to Appellate Tribunal for Electricity (ATE) against the MERC's Multi Year Tariff (MYT) order for an additional relief of Rs800 mn for 1QFY2008 and Rs2.89 bn for FY2008. Our revised EPS estimates ' Rs26.7 for FY2008 (Rs28.8 previously) and Rs27.3 for FY2009 (Rs29.7 previously) incorporate the impact of new tariff formula in our model and higher revenues from EPC business. Our SOTP based target price at Rs780 (Rs620 previously) offers 13% upside from current levels. We believe that a strong and liquid balance sheet, predictable cash flows of existing business puts the company in an excellent position to exploit emerging opportunities in core power business. We retain our OP rating on the stock.

Operating performance on track. While the operating profits of the company were impacted by change in accounting policy on forex derivatives and delay in implementation of tariff order, the operating performance of REL continues to be on track. Dahanu Thermal Power Station (DTPS) operated at a PLF of 104.5% during 1QFY08 against a PLF of 104.3% during 1QFY07. The Samalkot Power Plant operated at a PLF of 56.7%, against 51.3% achieved last year. Gas availability continues to adversely impact the PLF of the plant.

Higher revenues from EPC business to continue as order book swells. We note that the order book of the company stood at Rs55.2 bn at the end of FY2007 as compared to Rs33.5 at the end of FY2006. The company has broadened its EPC foray beyond generation business and is now expanding into transmission and distribution projects. The key projects with the company include—2X300 MW thermal power station at Yamuna Nagar; 2X600 MW thermal power station at Hisar, rural electrification project in UP and 65-km long Allain Duhangan-Panarasa transmission project.

SOTP based target price of Rs780/share. Our SOTP based target price includes Rs320/ share as the core value of operating assets (Rs285 previously) comprising of Rs140/share for Mumbai generation and distribution business, Rs29/share for other generation assets, Rs71/share for stake in distribution companies in Delhi and Rs80/share as the value of the EPC business. The valuation of EPC business is based on 15% discount to the average implied EV/EBITDA of 14.4X for the capital goods/engineering companies.

Net cash contributes a significant Rs330/share (Rs230/share previously) to the value of the stock. We believe that the company is in an excellent position to leverage its financial and technical capabilities to execute large projects. We add Rs132/share as 50% of the likely value enhancement by utilizing the surplus cash in new projects. We note that the 600 MW thermal power project at Rosa has obtained all clearances and will likely be the first new project to commission for REL. Two large projects of REL—3,740 MW at Dadri and 1,400 MW at Shahpur in Maharashtra will likely move fast as and when there is clarity on availability and pricing of natural gas from Reliance Industries.

Equity investments could provide upside. REL is taking equity stake in infrastructure projects to capitalize on its strong balance sheet. While we have not ascribed any value for these projects, value enhancement from these projects could provide significant upside as well. Some of the infrastructure projects won by REL include—Mass Rapid Transit System (MRTS) in Mumbai, road projects for NHAI, real estate project in Hyderabad (along with Shobha Developers).

Reliance Energy -Quarterly summary, March fiscal yearends, Rs mn

		yoy		Our est.	yoy
	1Q FY2008	1Q FY2007	% chg	1Q FY2008	% chg
Net sales from Electrical Energy	12,854	9,176	40.1	10,351	12.8
Income from EPC and Contracts	3,386	2,373	42.7	3,500	47.5
Net sales	**16,240**	**11,549**	**40.6**	**13,851**	**19.9**
Cost of electrical energy purchased	6,711	3,137		3,414	
Cost of fuel	2,722	2,343		3,066	
Tax on electricity	353	314		329	
Cost of matl. & other direct exp.(EPC & Contracts)	2,917	1,912		3,115	
Personnel costs	996	686		750	
Other expenses and provisions	2,165	1,822		1,350	
Total expense	15,864	10,214		12,024	
EBITDA	**376**	**1,334**	**(71.8)**	**1,828**	**37.0**
Depreciation	581	719		550	
EBIT	(205)	615		1,278	
Other income	3,599	1,711		1,500	
Net interest	693	459		500	
PBT	**2,701**	**1,867**	**44.7**	**2,278**	**22.0**
Tax	317	263		391	
Deferred tax	169	(62)		-	
Net profit	**2,216**	**1,666**	**33.0**	**1,886**	**13.2**
Extraordinary income	-	100		-	
EBITDA margin (%)	2.3	11.6		13.2	
Effective tax rate (%)	18.0	10.8		17.2	
Growth (%)					
Sales	40.6	21.6		19.9	
EBITDA	(71.8)	(17.4)		37.0	
PBT	44.7	9.1		22.0	
PAT	33.0	6.4		13.2	
Cost to sales ratio(%)					
Cost of Electrical Energy purchased (as % of net sales from Elec. Energy)	52.2	34.2			
Cost of Fuel (as % of net sales from Elec. Energy)	21.2	25.5			
Tax on electricity	2.2	2.7			
Cost of matl. & other direct exp.(EPC & Contracts)	86.1	80.6			
Personnel costs	6.1	5.9			
Other expenses	13.3	15.8			
Segment Revenues					
Electrical Energy	12,986	9,340			
EPC & Contracts	3,398	2,422			
Others	0	2			
Total	**16,384**	**11,764**			
Less: Inter segment revenues	-	3			
Net revenues	**16,384**	**11,761**			
Growth (%)					
Electrical Energy	39.0	18.1			
EPC & Contracts	40.3	44.5			
Others	(88.2)	(66.0)			
Total	**-**	**22.7**			
Profit/ loss before tax & int					
Electrical Energy	889	1,330			
EPC & Contracts	172	151			
Others	(1)	(0)			
Total	**1,061**	**1,481**			
EBIT Margin (%)					
Electrical Energy	6.8	14.2			
EPC & Contracts	5.1	6.2			
Others	(300.0)	(5.9)			
Total	**-**	**12.6**			

Source: Company data, Kotak Institutional Equities

Reliance Energy, Sum-of-parts valuation

	Methodology	FY2008E Book value per share (Rs)	Per share value (Rs)
REL (Mumbai distribution, Dahanu)	**DCF to equity** Disc. rate:11% Terminal year growth: 2%	76	140
Other generating assets - BAPL, RSPCL, BSES Kerala Power, Windmills	**DCF to equity** Discount rate:11% Terminal year growth: Nil	17	29
EPC business	**Average implied EV/EBITDA** At 15% discount to 14.4X FY2009E for the Engineering sector in Kotak coverage universe.		80
Delhi Distcoms- BRPL and BYPL 51% equity stake	**20% discount to our DCF valuation** Discount rate: 11% Terminal year growth: 4%	26	71
Residual Book		324	
Cash and investible surplus on books	**Market value**		330
Total		442	**650**
Value enhancement from incr. capacity			**132**
Total			**782**
Target price			**780**

Note: Post the preferential equity offering, fully diluted equity stands increased to 208.5mn shares (161.5mn shares earlier)

Source: Company data, Kotak Institutional Equities estimates.

Technology

HEXT.BO, Rs143	
Rating	IL
Sector coverage view	Attractive
Target Price (Rs)	165
52W High -Low (Rs)	205 - 132
Market Cap (Rs bn)	20.3

Financials

December y/e	2006	2007E	2008E
Sales (Rs bn)	8.5	10.9	13.4
Net Profit (Rs bn)	1.3	1.4	1.8
EPS (Rs)	8.9	10.0	12.7
EPS gth	*16.1*	*12.3*	*27.3*
P/E (x)	16.1	14.3	11.2
EV/EBITDA (x)	12.8	9.6	7.2
Div yield (%)	1.1	1.1	1.1

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	25.5	-	-
FIIs	52.2	0.2	0.1
MFs	2.4	0.1	(0.0)
UTI	-	-	(0.1)
LIC	3.8	0.1	(0.0)

Hexaware Technologies: Sales execution challenges still an issue. Maintain Inline rating.

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- **Modest revenue growth, disappointing margin performance**
- **Maintain IL rating with a reduce Dec' 08 DCF based target price of Rs165/ share**

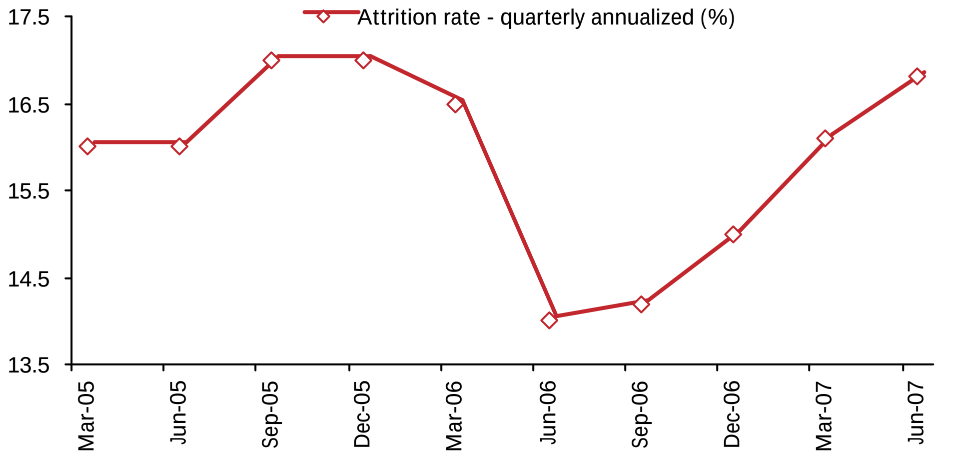
Hexaware's 2QCY07 revenues of US$64.06 mn (6.6% qoq growth at the lower end of the guidance) and net income of Rs261 mn (lower than the guidance) were lower than our estimates. The company just about managed to achieve revenue guidance at the lower end of the band. More importantly there are several lead indicators on the revenue growth challenges ahead including (a) decline in headcount for second consecutive quarter (b) decline in revenues from key large relationships and (c) discontinuance of even quarterly growth guidance. We suspect these challenges may be arising from (a) slippage in sales execution and (b) slower than expected progress on FocusFrame integration. We have cut our US$ revenue growth, EBITDA margin and rupee estimates from CY2007-CY2009. We reduce our end-CY2008 DCF based target price to Rs165. The stock does not have significant downside from the current levels. Upside hinges on increase in pace of growth, which can take two more quarters. Maintain In-line rating.

Modest revenue growth, disappointing margin performance: Hexaware reported revenues of US$64.1 mn for the Jun '07 quarter, a qoq growth of 6.6%. Revenue growth was led by (a) volume expansion of 2.7% and (b) increase in onsite component in overall revenues and improvement in onsite and offshore billing rates. Operating margin (EBITDA) declined 270 bps qoq and yoy to 12.3%. Margins were impacted by rupee appreciation (320 bps impact). Onsite wage revision by 5% and offshore wage revision by 17.5% impacted margin at a gross level by 4%. Impact of the above factors were offset by higher pricing, improvement in utilization and cost control. Net income declined 25.8% qoq and 12.3% yoy to Rs261 mn.

Challenges ahead: We believe that growth in CY2007 may be impacted by (a) sales execution challenges (b) ramp down from a couple of large relationships and (c) delay in integration benefits from FocusFrame acquisition. Our view is corroborated by (a) decline in headcount for the second consecutive quarter; (b) decline in revenues from top 10 clients and (c) discontinuance of quarterly guidance, which the company attributes to volatility in currency. We believe that challenges on sales execution may be due to slippages on cross sell of services and identification of appropriate profile of sales for large relationships. We believe that these are near term challenges which may take two to three quarters to rectify. We however believe that basic business model remains strong with creation of niche but scalable offerings, expansion of offerings in areas adjacent to core offerings which have a high scope for cross sell and presence of large base of scalable F-500 clients. We expect modest organic revenue growth in CY2007 but expect the growth to pick up in CY2008. With slippage in growth and recent rupee appreciation, we also expect the OPM expansion story to come under pressure; we expect EBITDA margin decline of 80bps in CY2007.

Revising estimates: We have revised our CY2007 and CY2008 EPS estimates downwards by 13%% and 12% to Rs10 and Rs12.8 respectively. We now factor in a Re/ US$ rate of 41.4 for CY2007 and 40 for CY2008 as opposed to 43 earlier. We have also changed our margin assumptions and now factor in a 80bps decline in OPM in CY2008 (as opposed to 20bps improvement earlier). We reduce our end-CY2008 DCF based target price to Rs165/ share. The downside in the stock may be limited but upsides hinges on revenue acceleration catalyst which may take some time coming.

Hexaware's worsening attrition rate indicative of the increasing supply side pressures



Source: Company, Kotak Institutional Equities

Key changes in CY2007, CY2008, and CY2009 estimates

	New			Old			Change (%)		
US$ mn	**CY2007**	**CY2008**	**CY2009**	**CY2007**	**CY2008**	**CY2009**	**CY2007**	**CY2008**	**CY2009**
Revenues (US$ mn)	**264**	**337**	**434**	**266**	**340**	**429**	**(0.7)**	**(0.7)**	**1.1**
EBITDA Margin (%)	14.8	15.3	14.9	15.8	16.0	15.8	(1.0)	(0.7)	(0.9)
EPS (Rs/ share)	**10.0**	**12.8**	**14.4**	**11.5**	**14.4**	**15.8**	**(13.0)**	**(11.3)**	**(8.8)**
Re/ US$ rate	**41.4**	**40.0**	**40.0**	**43.2**	**43.0**	**43.9**	**(4.3)**	**(6.9)**	**(8.8)**

Source: Kotak Institutional Equities Esimates

Comments: Hexaware Interim Results (consolidated) 2QCY07

Rs mn	2QCY06	1QCY07	2QCY07	% chg. qoq	% chg. yoy	Kotak estimates	% deviation	Comments
Revenues	**2,069**	**2,644**	**2,616**	**(1.0)**	**26.5**	**2,673**	**(2.1)**	6.6% US$ revenue growth to US$64.1 mn, lower than our expectation. Volumes growth at a marginal 2-3%. Headcount declined for the second consecutive quarter
Software Development Costs	(1,324)	(1,603)	(1,663)	3.7	25.6	(1,718)	(3.2)	
Gross profit	**745**	**1,040**	**953**	**(8.4)**	**28.0**	**955**	**(0.1)**	
Total SG&A Expenses	(434)	(645)	(633)	(1.9)	45.8	(625)	1.3	Previous quarter numbers include one-off expense of US$1 mn on sale as restructuring charge. This quarter numbers include a forex gain of Rs28 mn (1.1% of revenues)
EBITDA	**311**	**395**	**321**	**(18.9)**	**3.2**	**330**	**(2.9)**	EBITDA margin decline on account of wage revision (380 bps) and forex impact (320). Impact partially offset by pricing increase (60 bps), utilization improvement (110bps) and other cost controls (270bps)
Depreciation	(46)	(56)	(58)	2.3	25.6	(55)	4.7	
EBIT	265	339	263	(22.5)	(0.7)	275	(4.4)	
Other Income	46	68	50	(25.8)	8.6	69	(26.6)	
Profit Before Tax	311	407	313	(23.0)	0.7	344	(8.8)	
Provision for Tax	(13)	(55)	(52)	(5.3)	286.2	(49)	7.1	
Net Profit	**298**	**352**	**261**	**(25.8)**	**(12.3)**	**295**	**(11.5)**	Net income below expectations.
EPS (Rs/ share)	2.1	2.5	1.8	(25.8)	(12.3)	2.08	(11.5)	
No of shares outstanding (mn)	142.1	142.1	142.1	-	-	142.1		
As % of revenues								
Gross Profit Margin (%)	36.0	39.4	36.4			35.7		
Operating Margin	15.0	15.0	12.3			12.3		
SG&A Expenses (%)	21.0	24.4	24.2			23.4		
Billing Rates (US$/manhour)								
Onsite	65.8	66.5	66.9	0.6	1.7	67.3	(0.6)	
Offshore	22.9	23.3	23.4	0.6	2.2	23.5	(0.4)	
Revenue Mix (%)								
Onsite	60.4	62.1	64.7			62.2		Offshore revenues decline qoq in absolute terms
Offshore	39.6	37.9	35.3			37.8		

Hexaware Technologies: Consolidated Profit & Loss Statement Statement, December Year End (Rs mn)

Rs mn	2005	2006	2007E	2008E	2009E
Income From Software Development					
Overseas	6,787	8,482	10,931	13,508	17,379
Revenues	**6,787**	**8,482**	**10,931**	**13,508**	**17,379**
Software Development Costs	(4,173)	(5,318)	(6,796)	(8,609)	(11,230)
Gross profit	**2,613**	**3,164**	**4,135**	**4,900**	**6,149**
Selling and marketing exp	(641)	(771)	(1,016)	(1,205)	(1,511)
Administration exp	(885)	(1,071)	(1,497)	(1,632)	(2,049)
Total SG&A Expenses	(1,526)	(1,842)	(2,513)	(2,837)	(3,560)
EBITDA	**1,087**	**1,322**	**1,623**	**2,063**	**2,588**
Depreciation	(223)	(200)	(223)	(245)	(325)
EBIT	**865**	**1,122**	**1,399**	**1,818**	**2,263**
Interest	-	-	-	-	-
Other Income	146	241	244	305	290
Profit Before Tax	**1,010**	**1,363**	**1,643**	**2,123**	**2,553**
Provision for Tax	(97)	(101)	(225)	(307)	(511)
Net Profit	**913**	**1,262**	**1,418**	**1,816**	**2,042**
Extraordinaries	-	-	-	-	-
Net Profit- Reported	**913**	**1,262**	**1,418**	**1,816**	**2,042**
EPS (Rs/ share)	**7.6**	**8.9**	**10.0**	**12.8**	**14.4**
No of shares outstanding (mn)	119.4	142.1	142.1	142.1	142.1
Margins (%)					
Gross Profit margin	38.5	37.3	37.8	36.3	35.4
EBITDA Margin	16.0	15.6	14.8	15.3	14.9
EBIT Margin	12.7	13.2	12.8	13.5	13.0
NPM	13.5	14.9	13.0	13.4	11.8
Growth Rates (%)					
Revenues	24.3	25.0	28.9	23.6	28.7
Gross Profit	26.4	21.1	30.7	18.5	25.5
EBITDA	38.1	21.6	22.7	27.1	25.5
EBIT	38.9	29.8	24.7	29.9	24.5
Net Profit	44.1	38.2	12.3	28.1	12.5
As percentage of Sales					
-Overseas Revenue	100.0	100.0	100.0	100.0	100.0
-Domestic Revenue	-	-	-	-	-
Revenues	100.0	100.0	100.0	100.0	100.0
Software Development Expenses	61.5	62.7	62.2	63.7	64.6
Gross Profit	38.5	37.3	37.8	36.3	35.4
Selling Expenses	9.4	9.1	9.3	8.9	8.7
Administrative Expenses	13.0	12.6	13.7	12.1	11.8
S G & A Expenses	22.5	21.7	23.0	21.0	20.5
EBITDA	16.0	15.6	14.8	15.3	14.9
Depreciation	3.3	2.4	2.0	1.8	1.9
EBIT	12.7	13.2	12.8	13.5	13.0
Net Profit	13.5	14.9	13.0	13.4	11.8
Tax Rate	9.6	7.4	13.7	14.5	20.0

Technology

POLS.BO, Rs140	
Rating	U
Sector coverage view	Attractive
Target Price (Rs)	130
52W High -Low (Rs)	237 - 83
Market Cap (Rs bn)	13.8

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	10.3	11.6	13.7
Net Profit (Rs bn)	1.0	1.0	1.3
EPS (Rs)	10.3	10.5	12.9
EPS gth	*359.1*	*1.8*	*23.3*
P/E (x)	13.6	13.4	10.9
EV/EBITDA (x)	7.8	7.8	5.8
Div yield (%)	1.2	1.2	1.2

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	27.8	-	-
FIIs	3.1	0.0	(0.1)
MFs	8.4	0.2	0.1
UTI	-	-	(0.1)
LIC	-	-	(0.1)

Polaris Software Lab: Another quarter of disappointing operating performance. Maintain Underperform

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- **Results below expectations**
- **Products business continues to do well, services business slips further**
- **Improved client mining required to push growth in FY2008**
- **Maintain Underperform with a Mar'09 DCF based target price of Rs130/ share**

Polaris' Jun' 07 results were below our expectations. Revenues declined 4.9% qoq to Rs2.58bn (up 3.7% qoq in US$ terms), operating margins contracted 340bps qoq (700bps qoq) to 8.5% and net income declined 33% qoq to Rs144 mn. Intellect business continued to do well with six new client additions during the quarter though we do not know the quantum of orders. While the improvement in company's client base in the past few quarters has been impressive, the same is yet to be reflected in revenues. This once again highlights that execution, though improving, is still a work in progress. The business model risks remain with a high dependence on a few clients, uncertainty around success of Intellect product suite and continuity of execution challenges (with a weak employee profile). We have revised our FY2008 and FY2009 EPS estimates downwards by 15% and 5% to Rs10.5 and Rs12.9 respectively. We maintain our Underperform rating on the stock with a Mar'09 DCF based target price of Rs 130/ share (Rs150 earlier).

1QFY08 performance below expectations: Polaris reported 4.9% qoq revenue decline (3.7% qoq growth in US$ terms). Revenue growth saw an uptick from the 0.7% qoq US$ terms growth reported in 4QFY07. Products business continued the consistent performance (up 5% qoq in US$ terms) and now contributes 20.9% to Polaris' revenues. We believe that performance of the product 'Intellect' remains the key as the company has indicated its focus on using Intellect as an entry point into new accounts. Company's BPO subsidiary Optimus had a strong quarter and grew 8% qoq in Re terms (off a small base).

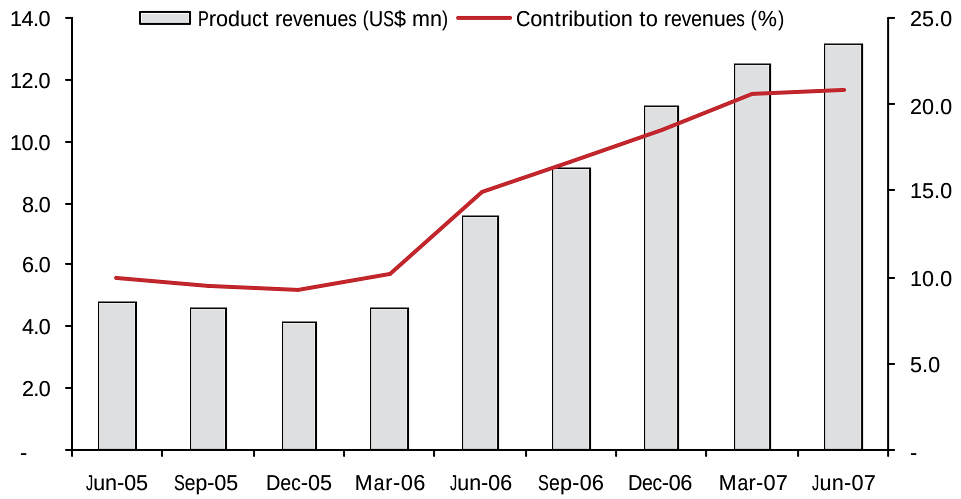
Extent of OPM decline surprising despite rupee appreciation: Polaris' OPM declined 340bps qoq to 8.5% in 1QFY08. More important, OPM decline yoy was 7% from 15.5% in 1QFY07. Margin decline was driven by (a) rupee appreciation (b) investments in sales and marketing and (c) onsite shift in revenues. While sharp appreciation in the rupee impacted margins significantly, we are surprised by the extent of margin decline given that Polaris does not effect significant wage increases in the Jun quarter. SG&A expenses as a % of revenues increased 110bps qoq to 22.5% as the company continued to invest in its sales and marketing activities. We factor in a 260bps decline in OPM in FY2008, driven primarily by rupee appreciation.

Product business remains steady, sustainability the key: Polaris' products business grew at a higher than company average rate of 5% (US$ terms). More important, the company signed up six new customers for its 'Intellect' suite, mostly in APAC region, and for different modules. Polaris once again emphasized on its strategy to utilize its product 'Intellect' as an entry point into new customer relationships and increasing Intellect's share of overall revenues. Sustainable growth in products business is the key in our view to overall revenue growth in the coming quarters.

Better client mining and more efficient operations remain the key to a good FY2008: We believe that Polaris needs to improve its client mining to drive acceleration in its revenue growth. Polaris now has 16AAA, 17AA, and 30A accounts, which provide it ample scope to improve on its 22% yoy US$ terms revenue growth of FY2007. The management reiterated its target of 25% revenue growth in FY2008, which we believe is achievable with better sales execution (we factor in 26% US$ revenue growth in FY2008). Also, while the company has been taking steps to iron out inefficiencies (it had roped in Arup Gupta from TCS, and he has initiated several programs to improve efficiencies), we believe that the company needs to increase its focus on driving revenue productivity and SG&A efficiencies to protect margins in the wake of the appreciating rupee scenario.

Revising estimates: We have revised our FY2008 and FY2009 EPS estimates downwards by 15% and 5% to Rs10.5 and Rs12.9 respectively. We have revised our revenue growth assumptions downwards by 3.5% for FY2008 (US$ terms) and now factor in a Re/ US$ rate of 40.5 and 40 for FY2008 and FY2009 respectively versus 43 earlier. We maintain our Underperform rating with a revised Mar '09 DCF-based target price of Rs130/share (Rs150 earlier).

Intellect has been growing strong and now contributes 20.9% to Polaris' overall revenues



Source: Company, Kotak Institutional Equities

Polaris Software Interim Results

Rs mn	1QFY07	4QFY07	1QFY08	QoQ % chg.	YoY % chg.	Kotak Estimates	% Deviation	Comments on QoQ performance
Revenues	**2,320**	**2,708**	**2,575**	**(4.9)**	**10.9**	**2,681**	**(4.0)**	Revenues declined 4.9% qoq versus our expectation of a 1% decline. US$ terms revenue growth was a modest 3.7% (driven by Intellect which grew 5% qoq)
Cost of revenues	(1,500)	(1,806)	(1,775)	(1.7)	18.4	(1,796)	(1.2)	
Gross profit	**821**	**902**	**800**	**(11.3)**	**(2.6)**	**885**	**(9.6)**	
Sales & marketing expenses	(220)	(316)	(310)	(1.8)	41.0	(322)	(3.5)	
General administration expenses	(241)	(264)	(270)	2.3	12.1	(265)	1.8	
SG&A expenses	(461)	(580)	(580)	0.1	25.9	(587)	(1.1)	
Operating Profits	**360**	**322**	**219**	**(31.8)**	**(39.1)**	**298**	**(26.3)**	Operating margin decline of 340bps qoq came as a negative surprise. Margin decline was driven by (a) rupee appreciation (b) onsite shift in revenues and (c) SG&A inefficiencies. Operating margin decline yoy stood at 700bps.
Non-operating Income	9	42	82	97.6	834.2	50	64.3	
EBIDTA	369	363	301	(17.0)	(18.2)	348	(13.3)	
Financial expenses	(2)	(3)	(2)	(44.3)	(4.8)	(2)		
EBDT	367	360	300	(16.8)	(18.3)	345	(13.3)	
Depreciation	(117)	(122)	(116)	(4.7)	(1.1)	(142)	(18.7)	Includes amortization of capitalized product development expenses
Pretax profits	**250**	**238**	**184**	(22.9)	(26.3)	203	(9.5)	
Tax	(47)	(24)	(40)	62.3	(15.4)	(24)	62.7	
Net profit	**203**	**214**	**144**	(32.6)	(28.9)	179	(19.3)	Net income 19% below expectations on account of lower than expected profitability
Extraordinaries	-	-	-			-		
PAT-Reported	**203**	**214**	**144**	(32.6)	(28.9)	**179**	(19.3)	
Period EPS								
EPS - recurring (Rs)	2.1	2.2	1.5	(32.6)	(28.9)	1.8		
EPS - reported (Rs)	2.1	2.2	1.5	(32.6)	(28.9)	1.8		
Margins								
Gross margin (%)	35.4	33.3	31.1			33.0		
SG&A expenses (%)	19.9	21.4	22.5			21.9		
Operating profit margin (%)	**15.5**	**11.9**	**8.5**			**11.1**		
Net profit margin (%)	8.7	7.9	5.6			6.7		
Billing Rates (US $/hr)								
Onsite	57.8	59.7	59.7	(0.0)	3.3			
Offshore	19.1	19.3	19.3	(0.4)	0.8			
Revenue Mix (Rs mn)								
Services	1,975	2,149	2,036	(5.2)	3.1			
Products	346	559	538	(3.7)	55.6			Intellect revenues (up a modest 5% qoq in US$ terms) continue to grow at higher than corporate average. Sustained momentum in Intellect revenues the key to company performance
Revenues from Citigroup (%)	51.7	40.6	39.6					
Revenues from Citigroup (Rs mn)	1,200	1,099	1,020	(7.3)	(15.0)			Slide in Citigroup revenues continues. Down 15% yoy.

Diversified

ABNL.BO, Rs1576	
Rating	IL
Sector coverage view	-
Target Price (Rs)	1,550
52W High -Low (Rs)	1625 - 604
Market Cap (Rs bn)	147.0

Financials

March y/e	2007E	2008E	2009E
Sales (Rs bn)	32.2	35.6	39.9
Net Profit (Rs bn)	2.1	2.3	2.5
EPS (Rs)	22.8	25.0	26.8
EPS gth	*2.5*	*9.9*	*7.1*
P/E (x)	69.2	63.0	58.8
EV/EBITDA (x)	31.9	30.1	27.3
Div yield (%)	0.3	0.4	0.4

Shareholding, March 2007

	Pattern	% of Portfolio	Over/(under) weight
Promoters	39.0	-	-
FIIs	18.6	0.3	(0.0)
MFs	9.2	0.9	0.6
UTI	-	-	(0.3)
LIC	7.9	0.7	0.4

Aditya Birla Nuvo: Too fast, too furious; reduce to In-Line

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- **ABN has run-up 25% over the last month without significant incremental news-flow.**
- **Stock trades very near to our revised target price of Rs1,550.**
- **Post Idea Cellular listing and announcement of private placement of ICICI Financial Services, we do not expect significant triggers for stock performance in the future, and, as a result reduce our rating on the stock to In-Line (from Outperform earlier).**

Aditya Birla Nuvo (ABN) has returned 25% over the last month versus 8% on benchmark Sensex, on no significant incremental news-flow. We revise our SOTP-based target price to Rs1,550 (Rs1,350 earlier) as we move valuations forward to FY2009E basis. We do not expect significant triggers in the future, and, as a result reduce the stock to In-Line.

Significant run-up with no significant incremental news-flow. The Birla group has reportedly hired two senior officials from ICICI-Prudential to run its ailing financial services business. Besides this, there has not been sny significant news-flow that leads us to believe that there is a fundamental shift in value of ABN's businesses.

We revise our SOTP-based target price to Rs1,550 from Rs1,350 earlier. We now value ABN's businesses on FY2009E estimates (vs. FY2008E earlier). That coupled with higher stock price of Idea Cellular and higher value for insurance business leads to the revision in target price.

We do not expect significant triggers to stock-price going forward. While we continue to expect decent growth in extant businesses of ABNL, we believe that the ruling stock price adequately prices them, and in absence of triggers going forward, do not expect the stock to outperform the benchmark.

We had expected listing of Idea Cellular and announcement of private placement of ICICI Financial Services to provide a benchmark to value to ABN's investment in Idea and insurance business. However, after these events, we do not expect significant triggers going forward. Hence, we lower our rating on the stock to In-Line.

SOTP-based valuation for ABNL, March 2009E basis, (Rs mn)

	Valuation base (Rs mn)		Multiple (X)		EV	Value
	Other	EBITDA	Multiple (%)	EV/EBITDA	(Rs mn)	(Rs/share)
Stake in Birla Sun Life insurance (74%)	(a)		90		26,313	282
Stake in Idea Cellular (31.8%)	(b)		90		97,284	1,043
Transworks and Minacs (BPO)	EV/ Sales				8,963	96
Fertilizers	DCFF				7,019	75
Garments	-	1,261		7.0	8,830	95
Rayon and allied chemicals	DCFF				5,552	59
Carbon black	-	1,532		5.0	7,659	82
Textiles	-	1,184		5.0	5,922	63
Insulators		464		5.0	2,321	25
Stake in Mutual fund (50%)	% of AUM				3,140	34
Stake in PSI Data System (70.4%)	EV/ Sales				592	6
Total					**173,595**	**1,860**
Less: Net debt					29,118	312
Equity value (Rs)					**144,477**	**1,548**
Target price (Rs)						**1,550**

Notes:

(a) We have valued 74% stake in Birla Sun Life insurance at Rs282/ share afer applying 10% subsidiary discount.

(b) We have valued 31.8% stake in Idea Cellular after applying 10% subsidiary discount.

(c) We have valued Fertilizer's business based on DCF-to-firm on normalised long-term full capacity EBITDA, adjusted for project capex.

(d) We have valued 50% stake in Birla sunlife mutual fund at 5% of equity AUM and 3% of debt AUM

Source: Kotak Institutional Equities estimates

Insurance

Bajaj Allianz NBAP margin likely higher than our estimate, increasing SOTP estimate

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- **Bajaj Allianz NBAP margin likely at 22%**
- **Raising SOTP contribution to Bajaj Auto from Bajaj Allianz to Rs750 per share from Rs467**

Based on our discussion with Bajaj Auto's management, we believe Bajaj Allianz Ltd will likely declare a new business margin of Rs7.1bn or 22% on first-year premium. Adjusted for a higher tax rate of 35%, the NBAP margin will be around 16.8%.We have been penalizing the company for higher surrenders and less profitable single-premium products. Based on this recent information, we are revising our margin estimate to around 14.7%, up from 8.8%, and our estimate for Bajaj Auto stake in Bajaj Allianz to Rs750 per share from Rs467. Note that we assume a 50% probability that the government will increase FDI investment to 74% and accordingly value Bajaj Auto stake at 38%, rather than 26% economic value as indicated by the management recently. Bajaj Auto will get higher value for its investment in Bajaj Allianz if the FDI regulations are not changed by the year 2016. At 26% economic value, Bajaj Allianz will add around Rs515 per share to Bajaj Auto as against our earlier estimate of Rs320.

Key assumptions

Premium collection (Rs mn)

	Individual Single Premium	Individual regular premium	Group Single Premium	Group regular premium	Total premium	Total annualized premium	% growth
2005	4,514	4,012	—	73	8,600	4,537	
2006	15,062	11,848	33	212	27,156	13,570	199
2007	11,791	30,275	76	555	42,697	32,017	136
2008E	8,000	51,468	129	944	60,540	53,224	66
2009E	8,000	77,201	181	1,321	86,703	79,340	49

Other assumptions

Embedded value (Rs mn)	38,074
No of shares o/s of Bajaj Auto (mn)	101
Holding company discount	0

Source: Kotak Institutional Equities

Sensitivity analysis indicating value of firm at different margin and multiple assumption

Structural value (Rs bn) = NBAP * multiple

	Margin (%)					
Multiple (X)	**10.8**	**12.7**	**14.7**	**16.7**	**18.6**	**15.7**
14	119.4	141.3	163.2	185.1	207.0	174.9
16	136.5	161.5	186.6	211.6	236.6	199.9
17	145.0	171.6	**198.2**	224.8	251.4	212.4
18	153.6	181.7	209.9	238.0	266.2	224.9
20	170.6	201.9	233.2	264.5	295.8	249.8

Appraisal value (Rs bn) = Structural value + Embedded value

	Margin (%)					
Multiple (X)	**10.8**	**12.7**	**14.7**	**16.7**	**18.6**	**15.7**
14	157.5	179.4	201.3	223.2	245.1	213.0
16	174.6	199.6	224.6	249.7	274.7	237.9
17	183.1	209.7	**236.3**	262.9	289.5	250.4
18	191.7	219.8	248.0	276.1	304.3	262.9
20	208.7	240.0	271.3	302.6	333.8	287.9

Contribution to sum-of-parts assuming full value for 38% (Rs per share)

	Margin (%)					
Multiple (X)	**10.8**	**12.7**	**14.7**	**16.7**	**18.6**	**15.7**
14	502.8	572.7	642.6	712.5	782.4	679.8
16	557.3	637.2	717.1	797.0	876.9	759.6
17	584.6	669.4	**754.3**	839.2	924.1	799.5
18	611.8	701.7	791.5	881.4	971.3	839.3
20	666.3	766.1	866.0	965.8	1,065.7	919.1

Contribution to sum-of-parts assuming full value for 26% (Rs per share)

	Margin (%)					
	10.8	**12.7**	**14.7**	**16.7**	**18.6**	**15.7**
14	344.1	391.9	439.7	487.5	535.4	465.1
16	381.3	436.0	490.6	545.3	600.0	519.7
17	400.0	458.0	**516.1**	574.2	632.3	547.0
18	418.6	480.1	541.6	603.1	664.6	574.3
20	455.9	524.2	592.5	660.8	729.1	628.9

Source: Kotak Institutional Equities

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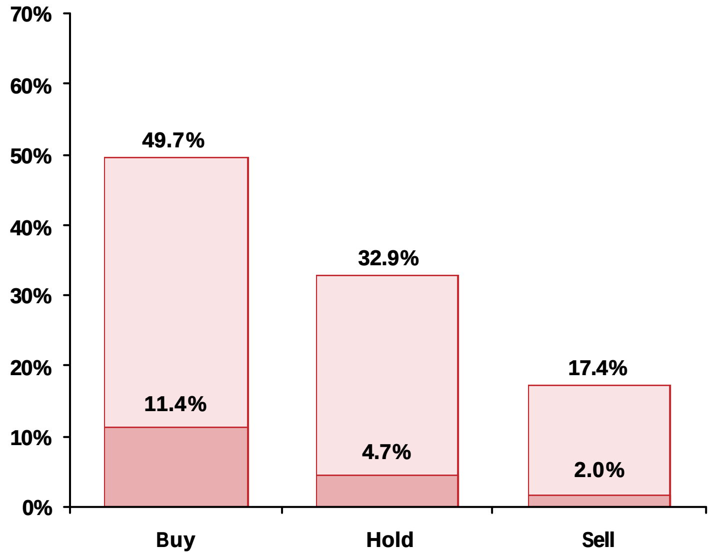

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Source: Kotak Institutional Equities. As of June 30, 2007

Ratings and other definitions/identifiers

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